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SUBJECT: Turkey's Military Pension Fund: Powerful, but Professional

¶1. (SBU) Summary. One of the many unique institutions with which outsiders often associate Turkey is its large and powerful military pension fund, which is often pointed to as a sign of undue military influence in politics and society. But, along with coups, squatter housing, leftist terror, and inflation, such specificities are fading away as Turkey joins the global economy. The pension fund, known as OYAK, no longer has special status or privileges and operates as a professionally-managed occupational retirement fund like others in Europe or the United States. OYAK's practice of taking equity holdings in commercial enterprises (as opposed to financial holdings of stocks and bonds) makes it susceptible to political pressure and economic nationalism, as is arguably demonstrated by its recent investments in Turkey's steel industry. In any case, the pressures of the marketplace and EU-related reforms limit the potential for abuse and are turning OYAK into an advocate of sound economic policy, transparent corporate governance, and EU accession. End Summary.

¶2. (SBU) With assets of over \$12 billion, OYAK, the Armed Forces Pension Fund, is one of Turkey's largest economic entities, ranking just after private industrial giants like the Koc, Sabanci, Dogus and Zorlu Groups. OYAK was created by law in 1961 to manage the retirement savings of military officers and civilian employees of the Ministry of Defense. In 2006, it has about 230,000 members, \$600 million in annual profits, and 18,000 direct employees. Reflecting its membership, OYAK's all-male board consists of generals and admirals, a university rector, and a provincial governor (all retired), as well as its professional CEO. Membership in OYAK is mandatory for uniformed personnel and optional for civilian defense employees, 80% of whom opt to join. OYAK membership and benefits are supplementary to required universal participation in Turkey's social security system, SSK.

¶3. (SBU) In October 2005, Oyak made a \$2.7 billion equity investment in Turkey's formerly state-owned iron and steel company, Erdemir, which runs ageing steel factories along the Black Sea coast and the massive Isdemir works on the Mediterranean Gulf of Iskenderun. OYAK's other equity holdings include the medium-sized Oyak Bank and joint ventures with foreign companies including the French companies Renault for automobile manufacturing and AXA in the insurance sector. The Fund also has equity holdings in Turkish cement, energy, telecom and other companies. The Fund has a policy against investing in the defense sector and tends to prefer investment in wholesale businesses that are not "brand names." OYAK has no institutional relationship with the Armed Forces Foundation (TSKGV), a military-run body that owns enterprises that produce military equipment.

The Military's Hidden Hand?

14. (SBU) OYAK has been accused, particularly from European quarters, of being a tool used by the Turkish military -- or, more broadly, the putative "deep state" -- to influence democratic civilian politics. A 2003 report by the "European Economic and Social Committee" called OYAK "the secret hand of the Turkish army."

A European Parliament commission report that same year contained similar conclusions. Former French Ambassador to Turkey and journalist Eric Rouleau has said much the same, and called on the Turkish government to end special privileges enjoyed by OYAK. On the other hand, no "political" document of the European Union (such as those of the Copenhagen summit) has cited objections to OYAK or its status.

15. (SBU) OYAK executives assert that OYAK is a professionally and transparently managed pension fund, differing from other occupationally-based pension funds only in that it includes large -- in many cases controlling -- equity stakes in its investment portfolio, as opposed to only buying non-controlling shares in traded equities. The executives explain this by pointing to the relative thinness and small capitalization of the Turkish stock market. OYAK publishes annual reports and financial statements that are audited by international accounting firms in accordance with International Accounting Standards. For example, OYAK's 2005 annual report contains an auditors' statement by Deloitte Touche. OYAK has credit ratings from Moody's and Standard and Poors, and has issued bonds on international markets. OYAK also publishes extensive verbatim transcripts of its annual membership meetings, although these may be edited to delete commercially sensitive information.

Economic Nationalism vs. Sound Management

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16. (SBU) When current CEO Coskun Ulusoy took over in 2000, he brought with him from the Koc Group a team of outside business professionals like Executive VP Ergun Okur and Aydin Muderisoglu. The Fund has thrived under the new team, with assets mushrooming from \$5.8 billion in 2003 to 2005's \$12.3 billion. Ulusoy asserts that OYAK's "first duty is to safeguard the value of its members' savings." Nonetheless, observers sometimes perceive non-economic motives in OYAK's investment decisions. The decision to acquire Erdemir, which stretched the Fund's financial and managerial capabilities, is a recent example. Erdemir's privatization took place at a time of rising economic nationalism and fears that large foreign companies, like Mittal and Arcelor in steel, would take over key economic sectors. OYAK's high bid was welcomed by politicians as a "national" solution, while financial analysts viewed the price as excessively high. Similarly, there has been controversy in the press about OYAK's desire to sell its mid-size Oyak Bank to a foreign bank despite OYAK management's argument that a relatively small, nationally-based bank can not be competitive against major international banking giants, like Citigroup, BNP and Dexia, that are buying into Turkey's banking sector.

No "Special Privileges"

17. (SBU) OYAK officials also deny that the Fund enjoys special privileges. They rebut charges, such as Eric Rouleau's, that military banking accounts held at Oyak Bank are a hidden subsidy by explaining that individual military units' decisions on where to hold their salary accounts are commercially-based. In Turkey, ministries, the military, and private corporations pay salaries through the banking system. Banks compete for this business by offering non-cash incentives to the managers of individual units. In some cases, these incentives can be substantial, such as new cars or buildings. Oyak Bank has apparently won the business of many military units by providing such goodies to commanders, ostensibly for the enjoyment of their units. In any case, this issue will become moot once Oyak Bank is sold.

18. (SBU) Further reforms in OYAK's structure and relationships

will be necessary as part of Turkey's EU accession process. In particular, Turkey currently lacks a "second pillar" retirement insurance system that supplements government social security plans. Creation of such a system, as required by EU legislation, would require creation of an independent regulatory body and additional transparency regulations. OYAK executives say they would like to open up membership to non-military personnel and even the public, but such deregulation seems remote at the present given the priority EU countries give to government run social security systems.

Comment

19. (SBU) Unlike military-owned and operated commercial enterprises in some other countries, like China, OYAK is not a source of income that gives the Turkish military independence from the civilian financial control through the national budget. At the same time, there is no doubt that some politicians, particularly of the nationalist strain, see OYAK as a handy source of finance for would-be "national champion" companies. It is also true that OYAK, given its size and military origins, carries influence with politicians that could be used to protect its institutional and business interests. Indeed, the Fund's current management uses its influence to support the orthodox economic policies implemented by the AK Party government, including the IMF program. There is no evidence that OYAK uses its financial resources covertly to influence politicians. In fact, the author of the 2003 European Economic and Social Committee report, Tom Etty, has, according to OYAK executives, retracted his earlier views about OYAK's "secret hand." As Turkey proceeds on the path to EU membership, OYAK should continue the process of becoming a professional pension fund on the European and U.S. model.

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